



Mail Advertising Service Association International

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April 9, 1998

The Honorable John M. McHugh
Chairman, Subcommittee on the Postal Service
Committee on Government Reform and Oversight
House of Representatives
244 1 Rayburn Building
Washington, DC 205 15

Dear Chairman McHugh:

Enclosed with this letter are the comments of the Mail Advertising Service Association International on the proposed revisions to H.R. 22. I have also enclosed, at your request, a computer disk containing the comments in Word format.

I would be remiss if I did not say that notwithstanding the concerns expressed in the comments, MASA is encouraged by the reform effort and pleased that many of the concerns MASA previously expressed, in the testimony and follow-up responses by MASA's then Chairman, Dan Goodkind, have been addressed in the proposed revisions. We are particularly gratified that the revisions have eliminated the open mailbox test and would restrict the Postal Service's authority to enter into volume discount and negotiated service agreements to the competitive category of postal products. MASA's initial comments to H.R.22 as originally proposed were supportive of many aspects of the reform bill that have not been displaced by the proposed revisions. MASA remains a strong supporter of the reform effort being pursued by the committee. It is critical that postal reform be implemented to provide greater flexibility to the Postal Service and more efficient operations for the users of the mail.

As you will see from the comments, MASA's principal concern is that the Postal Service under postal reform will become the principal competitor of MASA's members. While the road has not always been smooth, over the years MASA members have partnered

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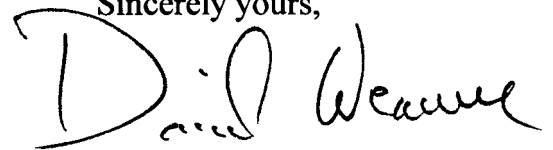
President & CEO
David A. Weaver, **CAE**
Alexandria, Virginia

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with the Postal Service to develop direct mail into one of the most productive communications methods for American business and membership organizations. During this time Standard (A) mail has been the most successful product offering by the Postal Service. We urge you to take the specific comments we have offered seriously and work to devise ways to afford the flexibility necessary for postal operations in the 21st century, while preserving the historical balance between private businesses and the Postal Service.

MASA thanks you for the opportunity to be heard on the important issues raised by your subcommittee's efforts to implement postal reform.

Sincerely yours,

A handwritten signature in black ink, reading "David A. Weaver". The signature is written in a cursive style with a large, stylized "D" and "W".

David A. Weaver
President

MAIL ADVERTISING SERVICE ASSOCIATION INTERNATIONAL
COMMENTS ON PROPOSED REVISIONS TO
H.R.22

The Mail Service Advertising Association International (“MASA”) continues to be a firm supporter of legislative reform of the United States Postal Service. The Postal Service is facing many challenges, ranging from increased competition for its core products from electronic media to the traditional problem of holding down costs where over 75% of its costs derive from labor. The health of the Service is critical to the American public and to the business community. It provides the most complete and, for many, the only form of written communications with others. The Service is in critical need of change in its regulatory regime to provide the flexibility needed to cope **with** these challenges.

MASA believes that many features of H.R. 22 and the proposed revisions are necessary to enable the Postal Service to have the control over its basic business operations, including pricing of its products, that any large business must have in order to provide its products and services in the most efficient and cost-effective manner. MASA, thus, approves of the objective of H.R. 22 to permit the Postal Service pricing flexibility for competitive and non-competitive products, and product flexibility to experiment with new services and ways of providing old services so that it can function in a rapidly changing modern and highly technological environment.

MASA believes, however, that these laudable goals have in certain cases been overwhelmed by counterproductive implementation proposals that are not appropriate for a government regulated monopoly whose fundamental purpose is the delivery of hard copy messages and packages. MASA strenuously objects, on both philosophical and practical grounds, to those provisions of the bill, as revised, that would permit the Postal Service to engage in competition directly with private business in areas that do not involve the delivery of mail or postal products and services. The fundamental justification for permitting this kind of encroachment on private enterprise – that profitable competitive activities subsidize monopoly Postal operations – is fundamentally flawed as a matter of theory. It is also fundamentally flawed in its proposed implementation – nothing in the bill as revised, requires that profits from competitive activities will subsidize core postal operations. As detailed below, MASA strenuously objects to the revisions that would establish the so-called private law corporation to permit Postal Service competition with private business.

MASA also believes that there are flaws in the provisions establishing the Competitive Products Fund and in the regulatory regime governing competitive postal products. While MASA is generally supportive of changes in the pricing mechanism for non-competitive postal products, there are significant questions that MASA believes should be addressed and clarified in drafting the statutory language. These matters are explained in detail below.

MASA’s specific comments follow.

COMPETITION IN NON-POSTAL PRODUCTS

The revisions to H.R.22 described in the staff report include provisions that would permit the Postal Service to form a so-called private law corporation, wholly owned by the Service, to enter into competition with private business in providing products or services that have no relation to its core activities of delivering the mail. The rationale for this sea change permitting the Postal Service to compete directly with private businesses is that such activities would generate profits that would ultimately benefit the users of Postal Service monopoly products and services.¹ This rationale is misguided as a theoretical matter, and would not accomplish its objective as a practical matter.

As a philosophical matter, the rationale that profits from private competition will subsidize regulated activity has no limiting principal. On this ground, Congress could authorize a host of government sponsored enterprises that would compete directly with the private sector for no reason other than that it would be a source of income to defray the expense of providing a government service. At its most extreme, the United States government itself could rationalize wholesale competition with American business because it would provide a new source of revenue to support government activities and thereby reduce taxes. It is hard to imagine the American public supporting this rationale for government intrusion in private enterprise. Moreover, it is difficult to see Congressional support for the governmentalization of private business upon which the private law corporation concept is founded.²

Equally damning, however, the private law corporation would not even fulfill this misguided objective, because there is no statutory guarantee that Postal Service competitive profits would benefit users of monopoly mail services. Under the revisions, the Postal Service would own all the stock in the corporation, which would be permitted to engage in any profit making activity it desired. It would be funded by capital contributions from the Competitive Products Fund, thus taking away an important source of capital from monopoly mail products and competitive postal products that are at the core of the Postal Service's mandate. Astonishingly, there is no requirement that any profits generated by the private corporation would benefit the Postal Service at all. There is no requirement that the corporation repatriate profits to the Postal Service, pay dividends, repay capital contributions or in any other way permit the Service to benefit from its profit-making activities. Indeed, if the Service desires, it can at its own discretion simply determine to plow every penny of its profits back into growing its non-postal business in competition with private business. Even on its own terms then, the rationale that the private corporation will benefit users of monopoly Postal services founders.

¹ MASA notes that, contrary to its assertion, the Postal Service does not now have broad authority to engage in competition with private business in non-postal matters. Instead, its competitive activities must fall within the scope of its charter, which is to engage in the delivery of mail and packages. Moreover, the Postal Service has not in fact engaged in broad-scale non-postal competition, as Postmaster General Runyon's recent report to the Committee on Appropriations attests (Report on Postal Service Activities, in compliance with the Conference Report P.L. No. 105-6 1 (February 1998)).

² COMSAT, Conrail and the U.S. Enrichment Corporation, cited as precedent in the subcommittee white paper, are not comparable to the proposed private law corporation. Each of these companies has a specific focused charter, is not owned by a regulated entity, and does not have broad and unfettered power to engage in competition with private business in areas outside its charter.

The proposal does not live up to its billing in other respects. The revision states that the private corporation would be forced to compete with private business on an equal footing. This is incorrect both with respect to the funding mechanism and with respect to the limitations on its dealings with the Postal Service, its 100% parent.

The funding mechanism, while somewhat hard to evaluate, would appear to create a very substantial commercial enterprise virtually overnight. It would do so on terms that are plainly not on the same footing as private enterprise. The Competitive Products Fund is to be the source for the Service's initial capitalization of the private corporation. But the Fund is not subject to state and local taxes, while private business surely is. Moreover, the Fund can make unsecured borrowings from the Postal Services Fund at T-bill rates, which private business cannot do and cannot replicate. The Fund also has available its initial capitalization plus profits from the competitive postal operations to further its non-postal competition.

The supposed protections against the Postal Service giving the private law corporation special treatment are wholly inadequate and unreliable. Operational personnel of the Postal Service would undoubtedly be in close contact with the operational employees of the private corporation. Indeed, one can expect that there would be a significant degree of cross-fertilization between the Service and the private corporation, especially because parent company employees could be hired by the private subsidiary and be free of restrictions on the amount of compensation Postal Service employees can receive. Whatever statutory prohibitions or internal rules may be established, there would be no effective way to monitor the relations between the Postal Service and its subsidiary to ensure that no preferential treatment was received.

COMPETITIVE POSTAL PRODUCTS

MASA supports many of the proposed revisions relating to the new class of competitive postal products. It is important to recognize that the Service needs a high degree of pricing flexibility for postal products that are truly competitive with products or services offered by private enterprise. To the extent the revisions achieve this goal, MASA fully supports them. In certain respects, however, MASA believes the bill as revised will create an unfairly competitive Postal Service, will not protect the core monopoly products, and will have no assurance that the benefits of competitive postal products will ultimately benefit the core functions of the Service.

The Competitive Products Fund is supposed to be structured so as to put competitive postal products on the same footing as those offered by private business. The Fund plainly would not do this. First, unlike private business, the Fund's profits are not subject to Federal, state or local income taxes.³ Second, the Fund can borrow at rates and terms that are not available to private business. The Fund can borrow on an unsecured basis, at T-bill rates from the Postal Services Fund (under § 2003(b)). No private business could borrow at such favorable terms. Third, the initial capitalization of the Fund would come from the transfer of *cash* equal to

³ Although state and local taxes are imposed on the obligations issued by the Fund, the profits generated by the competitive postal products are not taxed at any level. Although the staff justifies this treatment on the ground that the benefit of any profits would in effect serve as a proxy for taxation, this misses the point. If competitive postal products need not pay taxes, they are not on the same footing as private business.

the net asset value of those assets “attributed wholly or primarily to the production of competitive postal products.” The Fund would be able to use these same assets in the future (i) to provide postal products and services, and (ii) as security for additional borrowings authorized under the revisions. No private business would be able to obtain cash equal to the net value of its assets *and still retain those assets for its operations and use them to secure future borrowings*. In short, the revision would create a huge commercial enterprise virtually overnight on terms that are extremely favorable and wholly inconsistent with the protestations that the revisions are intended to put the competitive postal products and the private law corporation on an equal footing with private business.

MASA objects to the Fund for the additional reason that, as with the private law corporation, the bill does not have any requirement that the Fund will ultimately benefit the Postal Service and its core monopoly products. The Fund is structured so that any profits or other free cash generated in the Fund may be used at the discretion of the Service to fund competition with private business, either through competitive postal products, or through investments in the private law corporation. The only requirement affecting the use of these funds is that the competitive postal products cover their attributable costs and make a contribution to overhead that is equal to the average contribution made by all non-competitive postal products. Any surplus would not, except at the discretion of the Service, be used to reduce the overhead expense allocated to non-competitive postal products or in any other way defray the costs of the Postal Service core monopoly products. Since the only real justification for permitting the Postal Service competition with private business is to defray these expenses, the lack of any requirement that profits will be used to reduce monopoly costs is puzzling, to say the least,

Leaving aside the Fund itself, MASA supports many features of the revision relating to competitive postal products. MASA believes that it is sensible to:

- (i) eliminate the requirement of advance notice in the Federal Register of competitive postal product price changes, instead making the notice contemporaneous with the change;
- (ii) make competitive postal product pricing decisions subject to judicial review;
- (iii) require competitive products as a whole to bear an equal share of institutional costs compared to the non-competitive classes of mail (although a question remains whether this requirement will, in effect, make it impossible to price competitive postal products competitively).

MASA nevertheless has serious objections to the modifications governing the competitive classes of mail. First, the definition of what is a “competitive postal product” is too vague. Under the revisions, the Postal Service could seek permission from the Postal Regulatory Commission to shift to competitive status any postal product over which it did not have monopoly power to set prices without fear of losing significant business. The staff refers to the FCC’s “dominant carrier” test as the standard that would be used to determine whether a product should properly be classed as competitive. But this test is applied in a very different business

and regulatory environment, and it is entirely unclear how the principles used by the FCC would apply in a postal context. For example, it is unclear how monopoly power would be determined – e.g., would it be determined on a product by product basis ? Is the relevant product market confined only to postal type products, or are other forms of message delivery to be included? How does the PRC determine the Postal Service's ability to engage in predatory pricing, etc.?

Second, MASA is very concerned that the test for conversion to competitive postal product status focuses exclusively on the determination of monopoly power, ignoring other considerations of at least equal importance affecting the health of the Service's core monopoly products. For example, if the Service seeks to shift to competitive status a monopoly product that would result in significant price increases for non-competitive postal products, under the current revisions the PRC could not take this factor into account.⁴ MASA strongly believes that one of the statutory factors the PRC should be required to take into account in determining a Postal Service request to confer competitive postal product status is the effect on the remaining rates in a subclass from which the Service is requesting that a postal product shift to competitive status.

Third, MASA is very concerned that the definition of "postal products" to include any product or service that is "incidental to" the delivery of letters, printed matter or parcels would permit the Postal Service to compete directly with lettershops, mailing houses, list advertisers and others who prepare mail for delivery by the Postal Service. MASA believes the definition of postal products should be tightened to make clear that preparation of mail for tender to the Postal Service is not a service "incidental to" the delivery of mail.

NON-COMPETITIVE POSTAL PRODUCTS

MASA generally supports the revisions to the regime governing the pricing of non-competitive postal products. MASA has a several specific questions or objections to certain aspects of the revisions, however.

First, the revision states that discounts in the non-competitive category would be subject to the "strict Commission practice" that a discounted rate must cover attributable costs and make the same per unit contribution to institutional costs as the class or subclass from which it is discounted. Of course, there is no such hard and fast rule applied by the Commission. Instead the Commission's preference in setting discounts is to maintain the per unit contribution to institutional costs as the subclass as a whole, but it deviates from this preference on a regular basis. In any event, it is not at all clear how this Commission "practice" can be squared with the provision that would permit pricing discretion within baskets of mail. If this practice is to co-exist with pricing discretion, it must be clarified to apply only to the Commission's initial decision establishing base rates or rates for a new product offering.

⁴ For example, if the Service were to shift saturation mail from non-competitive to competitive status, it would almost certainly cause an increase in cost for the remaining categories of mail in the ECR subclass. This is because saturation mail bears a relatively high portion of the institutional costs assumed by the ECR subclass. In order for the subclass to maintain the same percentage of institutional costs as before the shift, it would be necessary to increase the rates of the remaining rates within the subclass.

Second, while MASA supports a banding requirement, it has questions about how the 2% banding requirement proposed in the revisions would work in practice. Under the white paper, the Postal Service would retain discretion to set differential price increases within subclasses (including some increases that are greater than the maximum) so long as the basket as a whole does not exceed the permissible percentage increase on an annual basis. The revisions would constrain the Postal Service discretion so that prices could be set only within a band no greater and no less than 2% of the “*rate change permitted for that year*” for the entire basket. The staff has clarified that the band would permit rates in a range 2 points above the maximum to a 2 point decrease in rates. This is substantially different from the language in the white paper, and should be clearly spelled out in the statutory language. As clarified, the banding provision provides a welcome check on disproportionate rate increases while permitting rate decreases where appropriate.

Third, MASA’s support for the white paper provision permitting “banking” of unused price increases in a given year, is tempered by concern that the white paper does not make clear how the banking provision would work in practice. There appear to be some circumstances in which abuses would be possible. For example, it is unclear whether the banking of unused price increases would occur on a basket by basket basis or rate by rate basis. If it is the former, it would appear that a rate that had been increased more than other rates in a basket in one year could get an even greater increase in subsequent years because the unused cap could be applied disproportionately to it. A mechanism should be put in the bill to prevent sequential disproportionate annual rate increases for a particular rate category due to the banking provision.